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APPLICATION OF SOUTHWESTERN ELECTRIC POWER COMPANY FOR AUTHORITY TO CHANGE RATES	§ § §	**PUBLIC UTILITY COMMISSION OF TEXAS**

COMMISSION STAFF'S SUPPLEMENTAL RESPONSE REGARDING NORMALIZATION VIOLATION RELATED TO NOLC ADFIT TREATMENT

On October 13, 2020, Southwestern Electric Power Company (SWEPCO) filed an application for approval to change base rates with the Commission.

On September 20, 2021, the Commission issued an Order requiring the Staff (Staff) of the Public Utility Commission of Texas (Commission) and other parties to file replies to exceptions to the Proposal for Decision (PFD) by October 28, 2021. Staff timely filed its replies to exceptions to the PFD on October 28, 2021, but inadvertently neglected to include a response to SWEPCO's request for how to treat its net operating loss carryforward (NOLC) accumulated deferred federal income tax (ADFIT) to prevent a normalization violation with the IRS. Staff provides that response here.

I. RESPONSE REGARDING NORMALIZATION VIOLATION RELATED TO NOLC ADFIT TREATMENT

SWEPCO has asked the Commission to consider two alternate proposals if it adopts the PFD's recommendation to exclude the $455 million in NOLC ADFIT from rate base.[1] The first proposal is that, even if the Commission accepts the recommendation of the PFD, SWEPCO requests the Commission implement rates that include the $455 million NOLC asset in rate base until the IRS determines if exclusion of it would result in a normalization violation.[2] For reasons more fully described below and in briefing and exceptions, Staff does not support this proposal.

The alternative proposed by SWEPCO and supported by Staff would be an authorization by the Commission for SWEPCO to establish a regulatory asset for the return that would be associated with the inclusion of the stand-alone NOLC ADFIT in the calculation of rate base that

[1] Southwestern Electric Power Company's Exceptions to the Proposal for Decision at 28 (Oct. 7, 2021).

[2] *Id.*

would be written off if the IRS determines there would be no normalization violation.[3]

Of the two SWEPCO proposals, Staff recommends that the Commission adopt the second alternative – that is, set rates as recommended by the PFD and authorize SWEPCO to create a regulatory asset. Staff makes this recommendation for two reasons. First, Staff believes that the correct revenue requirement if the $455 million NOLC is added to rate base is not determined by merely adding the return on the NOLC asset in rate base as SWEPCO suggests. For all the reasons discussed in briefing and exceptions, the revenue requirement that includes the $455 million NOLC in rate base should not be different than the rate base resulting from adoption of the PFD. It is Staff's position that if an asset for which SWEPCO has received $455 million of compensation (the NOLC) is added back to SWEPCO's rate base, then the assets financed with that compensation must be removed from rate base so that SWEPCO does not recover a return on the same $455 million twice. By financing plant investment with the cash received from the tax allocation agreement, SWEPCO funded those investments with the tax attributes of its affiliates and not with its own debt and equity capital.[4] Yet SWEPCO seeks a debt and equity return on these assets by including them in rate base. Therefore, in order to reflect a true theoretical stand-alone calculation under SWEPCO's proposed revised methodology, those assets must be removed from SWEPCO's rate base if the NOLC deferred tax asset is added to rate base.[5] Staff would therefore argue that there is not a difference in the revenue requirement with and without the $455 million NOLC because the Commission must recognize all adjustments for a theoretical stand-alone calculation and not just one cherry-picked by SWEPCO.[6]

SWEPCO itself provides another possible way of determining the revenue requirement that is based on the "Regulatory Ratemaking Journal Entries" presented in SWEPCO's rate filing package outlined above. In these journal entries, SWEPCO indicates that the offset to including the $455 million in rate base is an adjustment to capital (SWEPCO labeled it "Debt/Equity").[7] As explained above, Mr. Hodgson acknowledged that the $455 million is not debt or equity while Ms.

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[3] *Id.*

[4] Tr. at 394:14-16.

[5] Tr. at 394:16-17.

[6] Tr. at 394:8-21.

[7] Rate Filing Package Schedule & Workpapers Volumes 1 through 11, SWEPCO Ex. 1 at WP B-1.5.17 (Dolet ADFIT Offset), tab titled "NOL Excess Entries" JE Nos. 1 and 3.

Hawkins testified that adding the NOLC to rate base does not create debt or equity.[8] SWEPCO gave up its right to use its stand-alone NOLC in the future in exchange for $455 million in cash payments. However, by adding that $455 million NOLC asset back to rate base while still including the $455 million of assets financed with the NOLC, SWEPCO has given up nothing in exchange for the $455 million under its proposed stand-alone method. Therefore, under a theoretical stand-alone methodology, it cost the company nothing to get the $455 million of cash payments. Thus, the $455 million has to be zero-cost capital if both the NOLC ADFIT of $455 million and the assets financed with the $455 million SWEPCO received for it are included in rate base. Recognizing this zero-cost capital using the capital structure and cost of debt and equity recommended by the administrative law judges (ALJs) in the PFD results in the following capital structure and overall rate of return:

Description	Balance	Weighted %	Cost	Weighted Cost
Debt	$2,521,046,613	46.39%	4.18%	1.94%
Equity	$2,458,534,232	45.24%	9.45%	4.27%
Contr. NOLC	$ 455,122,490	8.37%	0%	0%
Total	$5,434,703,335	100.00%		6.21%

Adding the $455 million back to rate base as advocated by SWEPCO and plugging this weighted cost of capital into the PFD revenue requirement calculation yields a total company revenue requirement of $1,259,998,068 or just $457,228 above the $1,259,540,840 total company revenue requirement recommended in the PFD. This represents a difference of 0.00036%, or less than four one hundredths of one percent. Thus, taking the $455 million of NOLC financed assets out of rate base or leaving them in rate base and including $455 million of cash payments received for the NOLC in capital structure as zero cost capital results in a very similar revenue requirement

Lastly, Staff advocates for SWEPCO's second alternate proposal because adopting SWEPCO's first proposal would set a troubling precedent and would be contrary to how rates have traditionally been set, likely causing confusion and uncertainty in ratemaking proceedings going forward.

[8] Tr. at 968:22-25.

II. CONCLUSION

Staff respectfully requests that the Commission adopt SWEPCO's proposal to create a regulatory asset regarding its NOLC ADFIT pending a resolution with the IRS regarding potential normalization violations.

Date: November 3, 2021

Respectfully submitted,

PUBLIC UTILITY COMMISSION OF TEXAS
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CERTIFICATE OF SERVICE

I certify that, unless otherwise ordered by the presiding officer, notice of the filing of this document was provided to all parties of record via electronic mail on November 3, 2021, in accordance with the Order Suspending Rules, issued in Project No. 50664.

/s/ Robert Dakota Parish__
Robert Dakota Parish